STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of ENDERS FARM ASSOCIATES for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	: : : : :	DETERMINATION DTA NO. 810774

Petitioner, Enders Farm Associates, 8311 Creekcrest Circle, Manlius, New York 13104, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Marilyn Mann Faulkner, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on March 25, 1993 at 10:15 A.M., with all briefs due by June 24, 1993. Petitioner, represented by Slotnick, Arno, Bertrand & Welch (Daniel J. Arno, Esq., of counsel), filed its brief on May 10, 1993. The Division of Taxation, represented by William F. Collins, Esq. (Kenneth Schultz, Esq., of counsel), filed its brief on June 10, 1993. Petitioner filed a reply brief on June 23, 1993.

ISSUES

I. Whether management fees paid to petitioner's general partner may be included in the original purchase price for the purpose of the real property transfer gains tax.

II. Whether finance charges paid to petitioner's limited partners based on a percentage of the selling price of real property may be included in the original purchase price as interest on a construction loan.

III. Whether petitioner proved entitlement to the residential exemption for subdivided parcels under Tax Law § 1440.7. IV. Whether petitioner demonstrated reasonable cause to abate the penalties imposed under Tax Law § 1446.

FINDINGS OF FACT

Petitioner, Enders Farm Associates, is a limited partnership whose business, according to the Limited Partnership Agreement ("partnership agreement"), was "the construction, development and sale of lots, houses and other structures together with related facilities, all of which are located in the County of Onondaga and Surrounding areas in the State of New York."

According to the partnership agreement signed on August 7, 1984, the general partners were (1) Express Development Corporation located in Washington D.C. and (2) Abdo Contractors, Inc. located in Manlius, New York, and the limited partners were (1) Newgate Corporation located in Athens, Greece and (2) Oakland Investments, Ltd. located in Beirut, Lebanon. The partnership agreement provided that the limited partners each contributed $50,000.00 and that additional contributions "shall be made by the Limited Partners".

Paragraph 9 of the partnership agreement provided as follows:

> "Each partner shall be given credit for his financial contribution, management and sales ability in accordance with the following charges against income:

	Percentage of Sales
Management Efforts - Express Development Corp.	10%
Selling Efforts - Abdo Contractors, Inc.	10%
Financial Charge - Newgate Corporation	15%
Financial Charge - Oakland Investments Ltd.	15%

> "Thereafter, profits/losses shall be shared in accordance with the following formula:

	Percent of Profit	Percent of Loss
Express Development	16.67%	50.00%
Abdo Contractors Inc.	16.67%	50.00%
Newgate Corporation	33.33%	0
Oakland Investments Ltd.	33.33%	0"

By letter dated September 5, 1990, an auditor with the Division of Taxation ("Division") informed petitioner that in her review of the records of the Clerk of Onondaga County she discovered that petitioner sold several unimproved subdivided parcels of real property for a consideration that aggregated more than $1,000,000.00. The auditor further noted that the Division's records indicated that petitioner had not filed transferor questionnaires in accordance with the Tax Law.

Thereafter, the auditor conducted a field audit of petitioner's sales of real property to determine the amount of transfer gains tax owed.

Petitioner filed two transferor questionnaires dated November 1, 1990. On the questionnaires, petitioner reported gross consideration of $3,675,000.00 for the sale of the subdivided lots. From this amount, petitioner made the following deductions as the original purchase price in calculating the gain subject to tax:

purchase price to acquire property	$ 365,000.00	
other acquisition costs		110,250.00
cost of capital improvement		2,832,250.00
allowable selling price		367,500.00
	Total	$3,675,000.00

At the conclusion of the audit, the auditor disallowed $368,180.00 claimed by petitioner to be management fees includable in the original purchase price. The auditor characterized the alleged management fees as payments to a related party for services that are general and administrative rather than construction supervision. The auditor also disallowed as part of the original purchase price operating costs of $38,286.00[1] and $1,104,541.00 in claimed finance charges on a loan by limited partners to petitioner. The auditor determined that the finance charges constituted returns on partners' investment and profit sharing not in connection with a construction loan. After these adjustments, the auditor determined taxable gain in the amount of $1,578,236.00.

The Division issued to petitioner a Notice of Determination dated February 14, 1992 for gains tax due in the amount of $157,824.00, plus $55,226.00 in penalty and $74,059.02 in interest, for the total amount due of $287,109.02.

[1]According to petitioner's brief, it is not disputing this disallowance (Pet. Brf., p. 4, ftn. 2).

Petitioner filed a petition, dated April 20, 1992 and received by the Division of Tax Appeals on May 1, 1992, challenging the entire amount assessed by the Notice of Determination. In the petition, petitioner alleged that the "Commissioner's determination is barred, in whole or in part, by the statute of limitations, having occurred more than 3 years from the Notice of Assessment";[2] that the Division erred in not allowing it to increase its original purchase price by the interest that was paid to the limited partners on a loan related to construction and/or financing of the project, and other related costs; that the Division erred in "not allowing an exemption of $1,000,000.00 per sale, since the Taxpayer is selling real estate improved by one-family residences"; and that the penalty and interest penalty should be cancelled.

The Division filed an answer, dated June 1, 1992, affirmatively stating, inter alia, that petitioner sold unimproved lots in a subdivision and not lots improved by single-family residences; that the Division properly disallowed certain costs claimed by petitioner as the original purchase price under the statute; and that the penalties were properly imposed pursuant to Tax Law § 1446 because petitioner failed to comply with the filing and payment provisions of Tax Law §§ 1447 and 1442.

At the hearing held on March 25, 1993, Richard Seikaly, president of Express Development Corporation, testified concerning the nature of the management fees and financial charges that petitioner claimed as part of the original purchase price in calculating gain under Article 31-B of the Tax Law. Mr. Seikaly testified that he was a mechanical engineer with 20 years experience in the development and construction of real estate projects and that the Enders Farms project was developed in a series of stages, with which he was directly involved, beginning with site selection, feasibility studies, and the financing and acquisition of the real property. When questioned as to his involvement in the engineering stage, Mr. Seikaly responded that he obtained the services of an engineering firm to do the design work concerning

[2]At hearing, petitioner withdrew its statute of limitations claim (tr. p. 9).

the roads, sewers and "everything that goes into a development of this kind" (tr., p. 44) and that he obtained the services of a land surveyor to do the layout and surveying.

According to his testimony, Mr. Seikaly was in Syracuse at least once every two weeks in 1983 during the beginning stages of the project and thereafter was in Syracuse less frequently. He described his presence and involvement in the project as follows:

> "Even though at various stages my presence here was not necessary, simply because of the activity that required my presence, but out of Washington we were administering a lot of the things that were going on. And it was almost daily contact with Bob Abdo, who was the contractor.[3] And whenever the need became necessary he either traveled to Washington or I came here."

Q. "Is it your testimony then, did you work for this project while in Washington, D.C.?"

A. "Yes, of course."

Q. "A lot of work?"

A. "Yes. Yes. Especially dealing with financial matters, relations with the limited partners, engineering matters. Because this project was not done at one shot, it was done in six stages. So, you really had six different projects going on the same piece of land."

Q. "What were those stages?"

A. "Construction stages and sales stages, financial stages. Each one had to be properly financed before it even started. And this is where the relationship with the market and the project and the limited partners were necessary to keep the thing going."

Q. "Why did you do that and not Mr. Abdo?"

A. "Well, Mr. Abdo and I go a long way back, and we're like a team. He is proficient in many areas and so am I, so we split responsibilities. And I normally have responsibility for general business outlook, for financial matters, engineering matters and construction from an engineering point of view. And Mr. Abdo has responsibility, and does a good job of actual supervision of construction and sales because he knows all the builders in this area and he knows the market very well." (Tr. pp. 45-46.)

* * *

Q. "The services you rendered were, then, general administrative?"

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[3] Bob Abdo was the president of Abdo Contractors, Inc., the other general partner of petitioner.

A. "I might add -- I don't know if everybody knows this -- a general partner is really responsible for everything that goes on in the project. If the project went haywire it would be our responsibility, not the limited partner. So by necessity we have to remain involved, if not by anything else."

Q. "You kept your fingers on this project all the time, is that your testimony?"

A. "Yes." (Tr. pp. 56-57.)

Mr. Seikaly described his management role in the project as more than just construction management. In accordance with the partnership agreement, he was paid 10% of all sales which over a nine-year period amounted to the $368,180.00 that was disallowed by the auditor. Mr. Seikaly claimed that the amount paid to him from 1983 through 1987 or 1988 was his sole source of income for those years. He justified the amount paid to him as follows:

Q. "Based on your experience, what is the normal compensation, say, for a general construction manager?"

A. "Well, you've been calling it construction management in these proceedings, I would like to call it management, not just construction, because construction management is just a piece of what management really does on a project like this. So, if I may, I will answer your question construction management on a contractual basis in an arms length situation is normally anywhere between 8 and 12 percent of construction cost. This is when the activity is limited to the supervision of an actual construction job. Doesn't include engineering and design."

Q. "Which you did?"

A. "That led to do or the creation of the project or any other activity, except the actual supervision of the contract. Which doesn't include financial responsibility, except in auditing what the contractor wants to be paid. So, it really doesn't describe the full scope of what we have done."

Q. "You did more than construction management, is that your testimony?"

A. "The construction management has two phases, one relates to engineering and objectives of the construction, the other is actually in-ground construction. The actual in-ground construction was done to the tune of 80 percent by Mr. Abdo. I might add, the first phase of this was let out on bid. In other words, we had the general contractor, who we got through bid. Following that, through local independent subcontractors, we were the general contractor."

Q. "You were the general contractor?"

A. "Yes. The partnership, through the management agreement that it had with both Mr. Abdo and myself, we decided to do it ourself and there was no added compensation for it; it was just the ten percent."

Q. "Ten percent of?"

A. "Sales."

Q. "Based on your experience, is this a common charge?"

A. "It is common. Actually, it's lower than common. Normally, a general partner in a partnership like this gets 40 percent. Since we were both equity as well as general partners we figured that the whole thing was fair on the basis of the way it was done." (Tr. pp. 46-48.)

Mr. Seikaly testified that the reason the limited partners financed the project was to avoid the risk, high interest rates and points associated with bank financing in the early 1980's.[4] He noted that by basing the finance charges on a percentage of sales, rather than on a fixed interest rate, the project eliminated the risk of foreclosure or bankruptcy that characterized the real estate market at that time.[5] According to his testimony, the limited partners

> "reinvested their equity of three hundred thousand, following which all profits following the sales were reinvested in lieu of obtaining revolving credit from a bank." (Tr. pp. 52-53.)

In his testimony at the March 25, 1993 hearing, Mr. Abdo testified that he had been in the construction business for 40 years and in the real estate business for 20 years. He confirmed Mr. Seikaly's testimony concerning Mr. Seikaly's involvement in the project. Specifically, he noted that Mr. Seikaly negotiated the sale price of the property, did all the financial arrangements, feasibility studies, correspondence with the bank and scheduling. Mr. Abdo responded as follows to questions concerning the management fees paid to Mr. Seikaly's corporation and the finance charges paid to the limited partners:

Q. "Based on your 40 years of experience in construction is [the $368,000.00 management fee] a lot of money?"

A. "No."

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[4]Mr. Hall, petitioner's accountant, testified that the start up costs of construction involved a $300,000.00 loan from the limited partners and a $300,000.00 loan from a bank.

[5]In his testimony, Bob Abdo noted that many contractors in real estate projects were folding because of the interest rates and that, in fact, petitioner obtained one piece of real property for the project after a foreclosure on a mortgage with an 18% interest rate (tr. p. 89).

Q. "Why is that?"

A. "Well, for the time spent and responsibility, it just isn't a lot of money."

Q. "Do you know what the normal construction compensation would be for someone in a similar position as his corporation?"

A. "Well, that's hard to say. I know we've hired engineers and they didn't contribute as much to a project as Mr. Seikaly did, and they were paid twice as much."

Q. "Based on your experience, does it occur that managers are paid a percentage of sales?"

A. "Yes."

Q. "How about limited partners being paid a percentage of sales for financing charges, is that an occurrence you've seen?"

A. "Yes, it is."

* * *

Q. "Could this project have been completed without his corporate help?"

A. "I doubt it."

Q. "Why is that?"

A. "I couldn't have done it myself. I couldn't have obtained the financing to put the project together." (Tr. pp. 88-89.)

With respect to Mr. Abdo's and Mr. Seikaly's separate responsibilities, Mr. Abdo testified as follows:

Q. ". . . You did not perform the same function as Mr. Seikaly's corporation?"

A. "No."

Q. "Your functions were different?"

A. "Yes. I was on a day to day supervision management type of a job. I would supervise the actual construction of the sewers and the installation of the water and --"

Q. "You didn't do any of the actual negotiations or financing?"

A. "I didn't do any of the financing. I did, jointly with Mr. Seikaly, some of the negotiations with contractors. We did work very close together on that. And with the engineers and the surveyors."

Q. "But there were things Mr. Seikaly's corporation did that you couldn't do?"

A. "That's correct." (Tr. p. 92.)

At the hearing, petitioner submitted into evidence a document listing each lot number, builder, the date construction commenced on each lot, the date each lot closed and the date the house on each lot closed. Mr. Abdo testified that this document was prepared from courthouse records. He claimed that these were the same records used by the Division's auditor of the 115 subdivided lots that were sold by petitioner between 1985 and 1992. Mr. Abdo testified that between 20 and 25 lots contained completed houses when the lots were sold to the builders who then sold them to the homeowner,[6] and that between 50% and 60% of the lots had homes substantially completed. Mr. Abdo stated that the type of single-family residence that was built on the subdivided lots took a minimum of five months from the time of excavation until completion. Therefore, concluded Mr. Abdo, in the document listing the various lot numbers and their respective closing dates, it can be assumed that a house was substantially completed when the difference between the lot closing and house closing was two months or less. Similarly, Mr. Abdo asserted that when there was a simultaneous closing of the lot and house, the home was fully completed.

On the document listing the closing dates, the following lots had a lot closing and house closing on the same date:

Section B, lot no. 24
lot no. 33
Section C, lot no. 113
lot no. 121
Section E, lot no. 86
Section F, lot no. 99
Section G, lot no. 60

In the following instances the document indicated that the house closing preceded the lot closing:[7]

[6]Mr. Abdo also testified that between 20 and 25 times petitioner executed a deed to the real property directly to the homeowner.

[7]Mr. Abdo testified that the house closing preceded the lot closing because in those instances the builder did not have the money to pay petitioner for the lot until the builder sold the home to the ultimate homeowner.

	Lot Closed	House Closed
Section B, lot no. 19	8/10/87	7/1/87
lot no. 23	7/25/86	2/2/86
lot no. 44	3/21/87	3/20/87
lot no. 46	10/8/86	4/3/86
Section C, lot no. 123	8/11/87	8/21/86
Section F, lot no. 55	2/15/90	10/26/89
lot no. 98	1/23/91	1/13/91

In all instances, the partnership sold only the lot to the builder and the builder sold the home and lot to the ultimate homeowner.

Mr. Robert D. Hall, who worked as petitioner's public accountant since 1983, testified that the project construction was managed by Mr. Abdo and Mr. Seikaly through their respective corporations; that Mr. Seikaly was directly involved in the construction on the job site or by way of telephone calls from Washington D.C.; and that basing Mr. Seikaly's management fee on a percentage of sales was common and that the amount he received over the nine-year period was not a lot based on the services rendered. Mr. Hall also testified that he added the management fees to the original purchase price based on the terms of the partnership agreement.

With respect to the finance charges paid to the limited partners, Mr. Hall testified that he considered the amount paid to the limited partners, which was based on a percentage of sales, to be finance charges or interest on a loan. He testified concerning the reasons for his conclusions as follows:

Q. "And why were they not partnership distributions, why were they interest payments?"

A. "Well, again, the partnership agreement dictates the terms of how you're doing the accounting. The income tax laws dictate another way of how to do it. The Gains Tax has a third way of calculating income. So, you've got three or four different ways to account for and you account for to be in accordance with the partnership agreement."

Q. "As interest charges?"

A. "As interest charges."

Q. "Is that your understanding of the Gains Law, also?"

A. "Well, the Gains Law deviates from both the general accepted accounting principles and it deviates from income tax purposes. So, the Gains Tax itself is a third method of accounting, if you would."

Q. "Do you stand by your accounting as being accurate under the Gains Law?"

A. "Yes."

Q. "I mean that, what I'm saying, that in fact these were interest charges?"

A. "My belief is that in accordance with the partnership agreement that's what they were."

Q. "Is it based on your experience? Is it common to have interest pegged to sales in these types of situations?"

A. "Is it common?"

Q. "Does it happen?"

A. "I've seen other cases that it's done. Again, I haven't seen a lot of them done on sales, but generally it has been done before." (Tr. pp. 68-69.)

When questioned as to what provisions under the gains tax law he relied on in claiming both the management fees and interest as part of the original purchase price, Mr. Hall responded as follows:

> "Well, again, the gains tax law says that cost of construction is, basically, the only cost you get in regards to the gains tax. And you go to the -- what's confusing about it, general accepted accounting principles as well as the income tax law provide for interest, real estate taxes, management fees and so forth and so on, should be capitalized and become part of the construction cost. So, you have the income tax law, which is different than the gains tax law. But, underneath general accepted accounting principles and under income tax laws all initial start up cost and so forth and so on are capitalized and then amortized over the number of lots you get, if you will." (Tr. p. 80.)

Mr. Hall also testified that he attended various seminars on the gains tax law and requested clarification from the Division concerning the residential exemption. Petitioner submitted a letter dated November 30, 1988, on the Division's letterhead signed by a tax technician responding to an inquiry about the gains tax law as it effected homebuilders. In the letter, relevant sections of the Tax Law and regulations were quoted (e.g., Tax Law §§ 1440.7 and 1443.5 and 20 NYCRR 590.43[g]). In addition, the letter contained the following paragraph:

> "Concerning the lots sold improved with residences to transferee's [sic] to be used

> as their residences, it is our opinion that the consideration received from such sales is not to be aggregated with the consideration received from the sale of vacant lots. The sale of the individual residences, however, would be separately subject to the gains tax if the consideration received for a single residence is $1 million or more."

SUMMARY OF THE PARTIES' POSITIONS

Petitioner argues that it has carried its burden of proving that the management fees and interest costs are directly related to the costs of construction and, therefore, should be added to the original purchase price in determining gains tax. In the alternative, petitioner claims that most, if not all, of the lots sold should be exempt from gains tax under Tax Law § 1440.7 as a sale of subdivided lots that have been improved with residences. Finally, petitioner argues that all penalties and interest penalty should be waived because it has demonstrated reasonable cause for failing to file and pay any gains tax.

The Division argues that petitioner did not sell lots improved with residences and did not sell the lots to transferees for use as their residences because petitioner sold only the lots themselves to builders who in turn sold the lots and residences to homeowners; that the management fees paid to Express Development were for services as a general partner and that such services were general and administrative in nature and not related to construction supervision; that the finance charges paid to the limited partners were based on capital contributions and not loans; and that petitioner failed to demonstrate that there was reasonable cause for failing to comply with the filing and payment provisions of the gains tax law.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property at the rate of 10% of the gain. Tax Law § 1440.3 defines "gain" as the difference between the consideration for the transfer of real property and the original purchase price. Under the statute, original purchase price means:

> "the consideration paid or required to be paid by the transferor; (i) to acquire the interest in real property, and (ii) for any capital improvements made or required to be made to such real property, including solely those costs which are customary, reasonable, and necessary, as determined under rules and regulations prescribed by the tax commission, incurred for the construction of such improvements. Original purchase price shall also include the amounts paid by the transferor for any customary reasonable and necessary legal, engineering and architectural fees

incurred to sell the property . . ." (Tax Law § 1440.5[a]; emphasis added).

The regulations set forth further descriptions, with illustrative examples, concerning what constitutes acquisition costs and capital improvements that would reduce the "gain" subject to tax (20 NYCRR 590.15, 590.16, 590.17).

Under 20 NYCRR 590.15, certain preacquisition and acquisition costs may be included in the computation of the original purchase price such as fees for marketing and feasibility studies and to survey real property. Under 20 NYCRR 590.16, costs directly or indirectly related to capital improvements made to the real property may be included in the original purchase price. Indirect project costs must be "specifically identified with a project" (20 NYCRR 590.16[d]) and include such costs as construction administration costs. The regulation provides that:

> "indirect project costs which relate to numerous projects must be allocated in a rational manner to the projects to which the costs relate based on the nature of activity that gave rise to the costs" (id.).

However, the regulation also provides that general and administrative costs, such as corporate management salaries, corporate office expenses and "similar costs which are generally incurred by all enterprises in the conduct of business", may not be included as costs related to capital improvements.

Petitioner contends that the management fees were directly related to both the acquisition and capital improvement of the real property. It argues that the unchallenged testimony specifically spells out this relationship noting that Mr. Seikaly's services included "on-site inspection, engineering, negotiation with contractors, construction supervision, consulting, marketing and feasibility studies" (Pet. Brf., p. 6), "design . . . and financial studies" (Pet. Brf., p. 9).

Relying on the exclusion for general and administrative costs, the Division argues that Mr. Seikaly's services related primarily to his role as a general partner who was vested with the responsibility of managing the property and business of the limited partnership. The Division contends that:

> "[t]he fact that the general partner's general and administrative duties may also have furthered one of the partnership's projects does not change the character of the

expense from a general and administrative one to one that is an allowable component of [the original purchase price]" (Div.'s Brf., p. 8).[8]

Based on Mr. Seikaly's testimony, as confirmed by the testimonies of Mr. Hall and Mr. Abdo, Mr. Seikaly's contributions to the project included negotiating the purchase price of the property, marketing and feasibility studies, engineering matters, his role as general contractor negotiating with subcontractors, and the general administration and coordination of the construction and financing of the capital improvements. If the partnership had hired a third party for these services, there is little doubt that the cost of such services would be included in the original purchase price as preacquisition and acquisition costs and direct and indirect costs of capital improvements (see, 20 NYCRR 590.15, 590.16).

It appears that the Division objects to the inclusion of the management fee on the ground that Mr. Seikaly is not a third party but a general partner raising the issue of (1) whether his fee resulted from arm's-length negotiations, and (2) whether Mr. Seikaly's services represented general and administrative costs that were not related to capital improvements but only to his role as a general partner in a limited partnership.

With respect to whether the fees paid to Mr. Seikaly fairly and justly represented the worth of his services, Mr. Hall and Mr. Abdo testified that based on their experience, management fees for a construction project are frequently based on a percentage of sales and that the payment for Mr. Seikaly's contribution was not overinflated but, in fact, was generally low for the type of services he rendered. The testimony was credible and there is no basis in

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[8] As noted by the Division's counsel in brief:

> "[t]he general partners are vested exclusively with the management of the property and business of a limited partnership, and a sole general partner in a limited partnership must run, contract for, and otherwise manage the firm, and in fact, is the only one who can act on its behalf. Special partners have no right to participate in the management of the firm and are prohibited from transacting partnership business and from being employed for that purpose as agents, attorneys, or otherwise, under penalty of being held liable as general partners." (16 NY Jur 2d, Business Relationships, § 1546 [emphasis added].)

this record to contradict the fairness of the amount paid for Mr. Seikaly's services.

With respect to the regulation's exclusion of general and administrative costs that "are generally incurred by all enterprises in the conduct of business" (20 NYCRR 590.16[d]), the regulation does not appear to apply to the present situation -- that is, to a general partner who focuses all his efforts on the one and only project of the limited partnership. From the language and total context of the regulation, the excluded "general and administrative costs" relate to the cost of running a corporation or partnership generally as opposed to the costs specifically associated with a project's capital improvements. Although it appears that Mr. Seikaly was responsible for recruiting and putting together the partnership, his fee arose after the partnership was formed and thereafter involved his management services, as set forth in the partnership agreement, with respect to the partnership's business of developing and constructing the real estate project in Onondaga County. The fact that Mr. Seikaly's role as a general partner and construction manager may have overlapped is not critical in the present context where the sole business of the partnership, consisting of two general partners and two limited partners, was the one real estate project, and where the nature of the services performed otherwise falls within the regulatory parameters of costs that may be included in the original purchase price. Thus, the gain should be reduced by the $368,180.00 management fee paid to Express Development.

B. Under 20 NYCRR 590.16(d), the original purchase price may include interest paid during the construction period on loans used to make capital improvements to real property. Citing case law, petitioner argues that the parties may contract for interest on the use or detention of money; that interest may be expressed in terms of a share of the profits from a given transaction; and that under a plain and fair reading of the regulations and terms of the partnership agreement, the $1,104,000.00 paid to the limited partners should be considered part of the original purchase price. Petitioner contends that structuring interest payments as a percentage of sales reflected good economics and good accounting practices because it correlated expenses with income and avoided the risk of project failure.

The Division argues that the characterization of the $1,104,000.00 payment to the limited partners in the partnership agreement is not binding on any taxing authority; that the amounts contributed by the limited partners were capital contributions not loans; that there is no evidence that any loan was executed; that the partnership did not issue Form 1099's to the limited partners; and that the finance charges were not paid on account of any construction loan and, therefore, are not deductible as "construction period interest".

The only purported evidence of a loan by the limited partners was the partnership agreement itself which provided that the financial charge of 15% of sales would be credited to the limited partners for their financial contributions. A plain reading of the partnership agreement, as requested by petitioner, would lead one to conclude that the finance charges constitute a return on the limited partner's capital investment. This reading is reinforced by subsequent events whereby the $1,104,000.00 payment to the limited partners appears to be the only return on their contributions.

Moreover, even if the finance charges may be characterized as interest on a loan for purposes of Federal tax law with respect to income or partnership taxation, such characterization has little if any relevance to New York gains tax law which has its own statutory framework (see, Matter SKS Associates, Tax Appeals Tribunal, January 12, 1991). 20 NYCRR 590.16(d) does not require that interest paid during the construction period on loans be included in the original purchase price. The regulation merely states that interest on loans illustrates the types of costs that may be included. To construe the regulation in petitioner's favor would defeat, or be out of harmony, with the statutory framework or purpose to tax the gain of investors in real property (cf., Matter of MCI Telecommunications, Tax Appeals Tribunal, January 16, 1992). In contrast to a third-party loan, where the investor in real property incurs interest payments to its detriment, here, the investors themselves are reaping the benefit of the interest payments on the loan in direct proportion to the sale price of the property. Notwithstanding whether investors characterize the return on their investment in real property as interest on a loan or a return on their capital investment, the end result is the same -- investors received payments based on the gain in the real property. A transferor in real property cannot escape gains tax by characterizing its gain in the transfer of real property as interest payments on amounts loaned to itself[9] for capital improvements. Based on these circumstances, the $1,104,000.00 payment to the limited partners does not qualify as part of the original purchase price.

C. Petitioner argues, in the alternative that the lots improved by single-family residences at the time they were sold to the builder and the lots with partially completed single-family residences constituted exempt sales under Tax Law § 1440.7. Petitioner asserts that ambiguities in the law, as well as tax exclusions, are to be construed broadly in favor of the taxpayer. In response, the Division contends that petitioner failed to meet its burden of proving (1) that the subdivided lots were improved with residences or (2) that petitioner transferred the lots to transferees for use as their residences.

Transfers of real property are exempt from gains tax when consideration is less than $1,000,000.00 (Tax Law § 1443.1). In order to prevent a transferor from avoiding gains tax by subdividing or selling off portions of a piece of property for less than $1,000,000.00, Tax Law § 1440.7 includes an "aggregation clause" which requires the aggregation of the consideration received on such multiple transfers (Matter of Executive Land Corp. v. Chu, 150 AD2d 7, 545 NYS2d 354, 356, appeal dismissed 75 NY2d 946, 555 NYS2d 692). Specifically, the aggregation clause of section 1440.7 provides that:

> "Transfer of real property shall also include partial or successive transfers, unless the transferor or transferors furnish a sworn statement that such transfers are not pursuant to an agreement or plan to effectuate by partial or successive transfers a transfer which would otherwise be included in the coverage of this article . . . provided that the subdividing of real property and the sale of such subdivided parcels improved with residences to transferees for use as their

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[9]The Tax Appeals Tribunal has adopted a "look-through" principle in determining whether an entity is the transferor or beneficial owner of the property for gains tax purposes (Matter of 307 McKibbon St. Realty Corp., Tax Appeals Tribunal, October 14, 1988). In making its determination in 307 McKibbon, the Tribunal relied on the definition of "controlling interest" in Tax Law § 1440.2 which, in the case of a partnership, means "fifty percent or more of the capital, profits or beneficial interest in such partnership." Based on the partnership agreement and the amount of their capital investment, the limited partners meet such definition.

residences . . . shall not be deemed a single transfer of real property." (Emphasis added.)

Contrary to petitioner's claim, the underlying issue with respect to whether the sale of subdivided lots falls outside the aggregation requirement is a question of petitioner's entitlement to a statutory exemption (see, Matter of Cove Hollow Farm v. State of New York Tax Commn., 146 AD2d 49, 539 NYS2d 127, 129). A party claiming an exemption under these circumstances must clearly demonstrate entitlement to the exemption (id.).

Furthermore, in questions of statutory interpretations, the taxpayer "must show not only that [its] interpretation . . . is plausible, but also that it is the only reasonable construction available" (Matter of Custom Shop 5th Ave. v. Tax Appeals Tribunal, ___ AD2d ___, 600 NYS2d 295, citing Matter of Dental Society v. New York Tax Commn., 110 AD2d 988, 989, 487 NYS2d 894, affd on mem below 66 NY2d 939, 498 NYS2d 797; see, Matter of Howes v. Tax Appeals Tribunal, 159 AD2d 813, 552 NYS2d 972). Petitioner's interpretation of the statutory language to exempt petitioner's sale of subdivided lots to builders (who in turn then sell the lots and residences to homeowners) is not plausible. The builders, and not petitioner, sold lots improved with residences to transferees for use as their residences. Petitioner's role in the chain of events was to sell only the subdivided lots to the builders. The fact that builders commenced or completed the construction of residences on those lots prior to the actual transfer of the lots from petitioner to the builders does not entitle petitioner to the residential exemptions. Thus, under a plain reading of section 1440.7, petitioner's sales do not fall under the statutory exemption for two reasons. First, petitioner sold the lots alone and not the improvements on those lots. Secondly, petitioner sold the lots to builders and not to the homeowners who use the property as their residences.

Petitioner argues that because petitioner's sale of lots to builders was completed at the same time as the builder's sale of the lot and residence to the homeowner, then petitioner was, in effect, "part and parcel" of the ultimate transaction to the homeowner. Petitioner's attempt to construe the sequence of events in this manner to fit the residential exemption is neither plausible nor the only reasonable construction of the statute. In sum, petitioner has not met it burden of proving its entitlement to the residential exemption under Tax Law § 1440.7.

D. Finally, with respect to the imposition of penalty, Tax Law § 1446.2(a) permits abatement or waiver of penalty and interest penalty if it can be determined that petitioner's failure to timely pay the gains tax was due to reasonable cause and not due to willful neglect. The reasonableness of a taxpayer's failure to pay the tax must be evaluated in light of the Division's articulated policy (Matter of Benacquista, Polsinelli & Serafini Mgt. Corp. v. Commissioner of Taxation & Fin., 191 AD2d 80, 598 NYS2d 829, 832) and "the extent of the taxpayer's efforts to ascertain its tax liability" (Matter of KAL Associates, Tax Appeals Tribunal, October 17, 1991).

Petitioner asserts that the penalty should be waived because the gains tax law is "at best, vague, and at worst, contradictory", and that its accountant's method of correlating expenses with income was good accounting and permissible under general accepted accounting principles. Petitioner also noted that its accountant read the law, went to seminars on the topic of gains tax, and made an inquiry to the Division concerning clarification of the residential exemption for subdivided lots. Petitioner contends that after all his efforts, the accountant made a good faith interpretation of the law and concluded that no tax was due.

Despite the alleged efforts of petitioner's accountant to ascertain whether gains tax was due, petitioner has not demonstrated reasonable cause to abate the penalty. A taxpayer's reliance on professional advice "absolves noncompliance with the law only when that advice is reasonable under the circumstances" (Matter of Benacquista, Polsinelli & Serafini Mgt. Corp. v. Commissioner of Taxation & Fin., supra at 832). Here, in contrast to petitioner's argument, the accountant testified that he recognized that the gains tax law deviated from the income tax law and generally accepted accounting principles. If anything, recognizing these differences should have alerted or spurred the accountant to make further inquiries concerning the accuracy of his assumptions in reporting gain (see, Finding of Fact "19"). Moreover, the accountant's reliance on the November 30, 1988 letter from the Division (see, Finding of Fact "20") concerning residential exemptions was unreasonable. From that letter, it cannot be discerned what specific question the letter responded to. In any event, the November 30 letter referred to the statute and regulations themselves and gave no advice that would lead the accountant to conclude that the sale of subdivided lots alone to builders would qualify for the exemption on the basis that such sales are "part and parcel" of the builder's sales of the lots and residences to the homeowners.

Furthermore, the accountant's purportedly good faith conclusion that the management fees and finance charges were part of the original purchase price does not, in any event, excuse petitioner's failure to file a transferor questionnaire in the first instance. Considering the total context, petitioner has not demonstrated reasonable cause to waive the penalty for failure to comply with the filing and payment provisions of the gains tax law (see, Matter of Benacquista, Polsinelli & Serafini Mgt. Corp. v. Commissioner of Taxation & Fin., supra; Matter of Braunstein, Tax Appeals Tribunal, January 30, 1992).

E. The petition of Enders Farms Associates is granted to the extent indicated in Conclusion of Law "A" and is otherwise denied and the Notice of Determination, dated February 14, 1992, as adjusted by Conclusion of Law "A", is sustained.

DATED: Troy, New York
December 16, 1993

/s/ Marilyn Mann Faulkner
ADMINISTRATIVE LAW JUDGE